Monthly Note

Countries with ISP Subsidiaries

High frequency indicators show signs of moderation in a still-robust cycle in the CEE/SEE area. Inflation accelerating, mainly driven by fuel prices. Still easy monetary stances expected (except in CZ and RO).

The readings of several business cycle's coincident and forward-looking indicators weakened in the first months of Q2 with respect to Q1 in the CEE/SEE area, signaling that the regional economic growth, although still sustained, is shifting to a more moderate path. In May, CEE/SEE industrial production growth decelerated to 3.7% yoy from 6.5% in Q1, and in June, the PMIs and ESIs (in the countries where they are recorded), even if staying close to their historical highs, fell below the peaks of the previous months. In June, Inflation accelerated in the whole region, ranging from 2.0% in Poland to 3.1% in Hungary for CEE countries and from 2.3% in Serbia to 5.4% in Romania among SEE countries, especially driven by the more volatile components of the basket (fuel and energy), as core inflation remained stable on average.

At their last board meetings, central banks of the CEE/SEE area overall confirmed easy stances for monetary policy, except the CBs of Czech Republic and Romania, which had already started tightening cycles in August 2017 and, respectively, in January 2018. Due to expectations of rising short-term interest rates domestically, and risk premia at the international level, long-term yields have jumped in the last three months in Czech Republic, Romania, Poland and especially in Hungary. In the same period, exchange rates depreciated slightly in the same countries, while appreciated slightly in Serbia and Albania.

In the CIS area, according to preliminary estimates, in Russia economic activity accelerated to 1.8% yoy in Q2 while in Ukraine, GDP growth (+3.2% in Q2) was little changed from Q1. In Ukraine, inflation fell to 9.9% in June, closer to the CB's year-end target, but the monetary authority raised rates again on 12 July (+50bps, to 17.5%) in a surprise move to preserve financial stability amid tensions with the IMF. In the MENA region, the business cycle has continued to improve in Egypt, where GDP is estimated to have accelerated to 5.4% in the FY 2018 ending in June (from 4.3% in the fiscal year 2017).

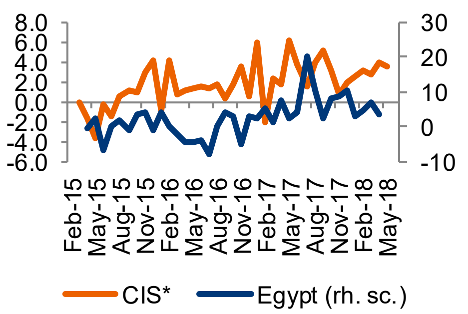
Bank loans showed a mixed performance in the CEE/SEE region, with strong dynamics in May confirmed in Romania (+6.4%), Slovakia (+8.9%) and Czech Republic (+5.1%), where CBs have introduced tighter regulations to the mortgage market to moderate growth. An acceleration was also seen in the countries with weaker performances in the past (such as Hungary [+7%]), but a slight decrease was recorded in Albania (-0.9% yoy). Albania showed a fall in deposits as well (-2.7% yoy). Deposits increased, in contrast, at a good pace overall, in particular in Hungary (+14.7%), Romania (+10.4%) and Bosnia (+9%). Growth rates for corporate deposits showed slight decelerations, but remained strong (over +10% yoy) in several countries. The household deposits performance was instead more moderate. Outside the CEE/SEE area, both lending and deposits accelerated in Russia (+10.5%) and Ukraine (+7.6%). NPLs remain at rather critical levels in Ukraine (over 56%). In Egypt, bank lending in March remained weak in the private sector (+7.6%) but rose significantly in the public sector (+40%), bringing total growth to 15%.

July 2018

Monthly note

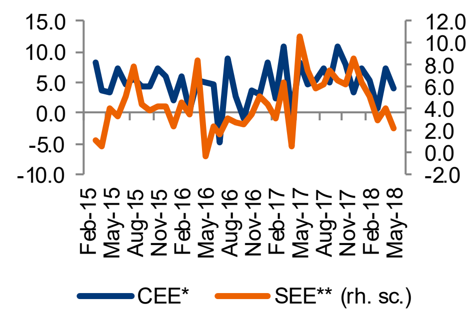
Intesa Sanpaolo
International Research Network

Industrial production % yoy – CIS – Egypt



Sources: National Statistics Offices; note * weighted average on Russia and Ukraine data

Industrial production % yoy – CEE – SEE



Sources: National Statistics Offices; note *weighted average on Slovakia, Slovenia Hungary, Czech Rep. and Poland data; **weighted average on Bosnia, Croatia, Romania and Serbia data

See the final page for important information.

Contents

ALBANIA
INTESA SANPAOLO BANK Albania

ROMANIA
INTESA SANPAOLO BANK Romania

SLOVAKIA AND CZECH REPUBLIC
VÚB BANKA

BOSNIA AND HERZEGOVINA
INTESA SANPAOLO BANKA Bosna i Hercegovina

RUSSIAN FEDERATION
BANCA INTESA

SLOVENIA
INTESA SANPAOLO BANK

CROATIA
PRIVREDNA BANKA ZAGREB

SERBIA
BANCA INTESA Beograd

HUNGARY
CIB BANK

EGYPT
ALEXBANK | بنك الإسكندرية

UKRAINE
PRAVEX-BANK

This note has been coordinated by Gianluca Salsecci. The names of the authors are reported in the single sections.

The note considers the countries with Intesa Sanpaolo Subsidiaries: Slovakia, Slovenia, Hungary and Czech Republic among the CEE countries, with the addition however of Poland where ISP is present with a Branch, Albania, Bosnia, Croatia, Serbia and Romania among SEE countries; Russia and Ukraine among CIS countries; Egypt among MENA countries.

The figures in this document have been updated as of 18th July 2018.

Cross Country Analysis

CEE area

Antonio Pesce

In the CEE region, readings for high frequency economic data and the Economic Sentiment Indicator (ESI) were weaker in Q2 than in Q1, supporting our view that regional economic growth, although still strong, is moving on to a more moderate path. Industrial production, exports and retail sales slipped to 4.2%, 1.6% and 5.4% in May from, respectively, 4.5%, 2.3% and 5.8% in Q1, and the ESI moved to 111.2 in June from 111.6 in Q1.

At country level, in Czech Republic, in May, industrial production grew by 1.4% yoy, below the 1Q average (4.0%). Exports contracted to -2.2% yoy in nominal terms after an expansion of 6.4% in April. The ESI, although still close to the record high, fell to 109.8 in June. In May, Hungarian industrial production weakened to 0.4% a/a, well below the 1Q average (2.8%), but the corresponding working-days-adjusted figure was still robust (+3.8%). In the same month, exports were stagnant, but this occurred after having shown a strong dynamic in April (11.0% yoy). Even though the PMI edged down in June to 53, it stayed near its historical high and above the threshold of 50. In Poland, in June, the reading for industrial production was still high (6.8% yoy after 5.4% in May), but it remained below the Q1 average (9.1%). In May, the real retail trade dynamic had strengthened further (6.1% yoy), and in April, exports had returned to a positive trend (3.7% yoy in nominal term), after the contraction observed in March (-3.65%). The ESI remained stable in June with respect to May.

In Slovakia, industrial production growth softened to 2.5% yoy in May from 4.1% recorded in the previous month while exports decelerated to 7.3% yoy after the record growth rate shown for the year in April (9.4%). In Slovenia as well economic conditions remained solid in the first two months of Q2, as highlighted by the performance of both industrial production (5.9% yoy in May) and exports (13.8% yoy in April), even though the outcome of the former was below the Q1 average (8.2%). The ESI softened in June with respect to May in Slovakia, but remained stable in Slovenia.

In June, the inflation rate increased in the region, ranging from 2.0% (from 1.5% in Q1) in Poland to 3.1% (from 2% in Q1) in Hungary. The acceleration of inflation is being driven primarily by the more volatile components of the basket, ie, fuel and energy, as core inflation has remained stable.

Monetary policy in CEE countries is expected to remain easy overall. At its July meeting, the Hungarian CB maintained loose monetary conditions and the policy rate unchanged at 0.9%. With respect to three months ago, however, short-term interest rates have increased in Hungary (by 20bps, to 0.3% in mid-July) together with long-term interest rates (+110bps in the same period to 3.5% in mid-July), due to expectations of higher inflation and a higher risk premium over German Bunds. In Slovakia and Slovenia, easy monetary conditions are warranted by the stance of the ECB. In contrast, in Czech Republic – where inflation had been rising in previous months – the CB had already started a tightening cycle in August 2017 and in June further increased the policy rate by 25bps, to 1.0%. Exchange rates vs the euro in Hungary and Poland, but also (even if to a lesser extent) in Czech Republic depreciated slightly vs the euro over the last few months.

Davidia Zucchelli

In the CEE region, banking aggregates strengthened as of May. Lending growth continued to be supported particularly by households in Slovakia, Slovenia and Czech Republic, and by the corporate sector in Hungary. The deposit increase remained dynamic, especially for corporates. Interest rates remained low, in line with money market rates.

In Czech Republic, lending decelerated further (5.1% yoy as of May from 6.5% in 2017), supported particularly by the household sector (7.5% yoy) which covered 60% of total loans to the private sector, while growth of corporate loans remained low (1.6% yoy). Deposits were also dynamic (+5.4% yoy in February, after +7.6% yoy in 2017), decelerating among corporates (to

1.8% yoy) but accelerating among households (to 6.9%). Foreign liabilities grew by 6.8% yoy (they accounted for over 50% of deposits from the private sector).

In Hungary, loans confirmed a strong recovery as of May (+7% yoy from +4.9% yoy in the previous month), supported by corporates (11.9% yoy), while loans to households increased slightly (1.7 yoy). As of May, deposits showed the same percentage yoy increase (+14.7%) as in April (+14.6% yoy), particularly from enterprises (+20.4% in May). Household deposits were also dynamic (+9.6%), even given a fall in deposits in foreign currency (-4.8% yoy). Supported also by the improving macroeconomic context, foreign liabilities jumped by 8.9% as of May.

In Poland, loans accelerated (+5.8% yoy in May from 4% yoy in April) both in the corporate (+7.5% yoy) and the household (+5% yoy) sectors. Deposits increased as well (+5.5% in May from 3.7% in 2017), particularly among households, at +6.1% yoy, while corporates showed a more modest increase (+3.6%). The strong loan dynamic vs deposits pushed the LTD ratio over 100%. Foreign liabilities continued to decline (-11.7% yoy in February from -13% in 2017).

Lending growth continued to be strong in Slovakia as well (8.9% yoy in May from 9.6% in 2017), fuelled by economic growth and low interest rates, both in the corporate sector (by 4.1%) and especially in the household sector (by 12.8%), driven by a further rise in mortgages. Deposits also grew (6.4% yoy from 5.2% yoy in December 2017) from both households (4.6%) and corporates (9.3%, up from 6.7% yoy as of December). Foreign liabilities decreased by 14% yoy.

In Slovenia, total loans confirmed a moderate dynamic (+2.7% yoy, as recorded in the previous three months), still driven by households (+6.2%, specifically, +4.2% in housing loans and +11.7% in consumer loans) while corporate lending decreased by 0.8% yoy in May. NPL amounted to 5.2% of total loans, mainlyin the corporate sector (with an NPL ratio of 11.2%). Regarding deposits (+7.7% yoy in May in the private sector), the corporate sector remained very dynamic (12% from 10.4% yoy in April) while deposits from households increased at a lower rate (by 6.2% yoy from 5.9% in the previous month).

SEE area

Antonio Pesce

High frequency data have confirmed, overall, the consolidation of the economic cycle among SEE countries, although (as in the case of CEE countries) at a slower, more sustainable rate. Industrial production and exports slowed to 2.2% and 6% in May from, respectively, 4.8% and 7.2% in Q1 (but the pace of retail sales improved slightly, to 5.9% from 5.5%) and the ESI fell to 104.2 in June from 105 in Q1.

The export growth rate remained in double digits in Albania and Bosnia as well (in the former case, at 18.0% yoy in June, and in the latter, at 12.1% yoy in May). In Croatia, industrial production contracted slightly for the third consecutive month (-0.6% yoy), even though the dynamic for exports was positive in April (15.7% yoy). In Romania, in May, industrial production decelerated to 1.2% yoy from 3.6% in April and remained below the Q1 average (5.2%); also, exports decelerated in May, but the dynamic was still strong (5.2% yoy). In June, the ESI remained high and close to the previous month's level. In Serbia, following the good performance in April (3.1% yoy), industrial production decelerated to 0.5% in May, well below the Q1 average (6.0%); however, in the same month, exports growth increased to 5.1% yoy.

In June, inflation increased in SEE countries overall. In Romania, in particular, it remained at a five-year high of 5.4% (well above the upper bound of the central bank's corridor target of 1.5-3.5%). In the other countries, it moved in a range between 1.3% in May in Bosnia (from 0.8% in Q1) and 2.4% in June in Albania (from 1.9% in Q1). Inflation was driven by energy prices, while core inflation was stable - and still low in several cases, such as Croatia (0.7%) or Serbia (0.8%).

At their last meetings, the boards of all the central banks of SEE countries with ISP subsidiaries confirmed easy monetary policies (except Romania, where the CB started a tightening cycle in

January and both monetary rates and long-term yields recorded a strong increase in the past three months). Exchange rates were roughly stable vs the euro in the past few months, though slight appreciation was seen in Albania, due to the good performance of exports, and in Serbia and Croatia, supported by net capital inflows.

Davidia Zucchelli

In SEE countries, banking aggregates showed a mixed performance: decelerating slightly in some countries (particularly in Albania), but improving in others (especially Croatia). The corporate sector remained fragile in Albania and Croatia, but improved in Serbia. Despite low interest rates, deposits increased in all countries, apart from Albania, but at a slower rate than previously was the case.

Performances in Albania appeared to be the most fragile among ISP countries. Lending decreased further (-0.9% yoy as of May), particularly to corporates (-3.3% yoy) which accounted for most loans (more than 67% of total loans to the private sector) and decelerating to households (+4.3% yoy). The weak loan performance did not allow the NPL ratio to decrease to below 13%, however, despite write-offs. Deposits decreased further in the private sector (-2.7% yoy from -2.1% yoy); household deposits fell (-3.6%) while deposits from businesses increased (by 2.1%). In Bosnia, banking aggregates continued their positive trend. Loans increased by 6.7% yoy in May and deposits rose by 9% yoy (by 16% yoy for corporates and 6% yoy for households). A jump in foreign liabilities (+19.3% yoy) is the only new outlier.

An encouraging dynamic after a long weak period was recorded in Croatia. Loans increased by 1.9% yoy as of May (from -0.1% yoy in 2017). Corporate loans remained fragile (-0.4% yoy), but appeared to be improving thanks to a recovery in new lending flows, while household loans accelerated by 3.5% yoy. Deposits continued to grow (5.2% from 2.4% yoy in 2017), particularly from corporates, at 10.5% from 8.6% in 2017, and by 3.6% yoy from households. The performance recorded in the previous months has been confirmed in Romania as well. Loans increased in May (6.4% yoy from 6.8% yoy in Apri), particularly in the household sector, at 10% yoy, while loans to corporates increased by 2.6% yoy (3.4% yoy in April. NPL continued to decrease (to 6.2% of total loans). Deposits performed well (10.4% vs 10.8% in April).

In Serbia, in May, loans to corporates increased (although at a modest pace of 0.43% yoy but vs -2.1% in 2017) for the first time since November 2016. Total loans were driven by loans to households (8.2% yoy from 7.8% yoy), supported by easing credit standards for new loans. Loans in foreign currency increased by +3.6% yoy (from -0.5% in 2017), which led the share of loans denominated in foreign currency to 67.4% of the total loans to the private sector. Deposits continued to perform well (5.9% yoy, 10.3% from corporates and 3.6% from households). Deposits in foreign currency accounted for 70% of the total.

CIS and MENA areas

Giancarlo Frigoli

In Russia, according to preliminary estimates, real GDP growth accelerated to 1.8% yoy in Q2 from 1.3 yoy in Q1, even if it had lost some momentum in June (+1.1% yoy). The weaker GDP growth in June reflected the slowdown in industrial production (+ 2.2% yoy, from 3.7% yoy in May) and the fall in construction output (-1.3% yoy following a +5.6% yoy in May). However, the recent recovery in retail spending gathered pace. Retail sales growth came in at 3.0% yoy in June from +2.4% yoy in May. Consumers are benefitting from lower inflation, looser monetary policy, and improving labour market conditions. A boost to sales also came from demand linked to the Football World Cup. The modest decline in Russian inflation in June, to 2.3% yoy from 2.4% in May, was mainly a result of a sharp fall in fruit and vegetable inflation. And, while headline inflation is still weak, there were some tentative signs in the data that broader price pressures may be starting to build. Core inflation rose from 2.0% yoy in May to 2.3% yoy in June. These data are likely to reinforce policymakers' hawkish stance shown in last month's CB board meeting which indicated that the VAT hike coming into force at the start of next year likely has limited the scope for monetary easing.

On 12 July, the National Bank of Ukraine (NBU) unexpectedly hiked its benchmark policy rate by 50bps, to 17.50%. The NBU's press release mentioned three main factors as being behind this move, which marked the first increase of the rate since March, namely: a) inflation risks, which are still elevated, due to strong real wage growth and higher remittances which fuel domestic demand; although both headline and core inflation decelerated in June (to 9.9% and 9% respectively), core inflation remains relatively high, signaling that the underlying inflationary pressures are persistently strong; b) waning investor interest in Ukrainian sovereign debt amid developed market tightening; and c) higher risks surrounding the next tranche of the IMF bailout loan. Should the likelihood increase that the above-mentioned risks materialise or new significant threats to inflation and to macro-financial stability arise, the NBU said it would continue to raise the key policy rate to a level that is necessary to bring inflation back to targets over a reasonable time horizon.

In Egypt, inflation accelerated in June after the government slashed fuel and electricity subsidies to help reduce the budget deficit. The annual rate climbed to 14.4% from 11.4% in May. Because the cuts to fuel subsidies were enacted in early June, and electricity price increases did not go into effect until 1 July, the full impact on inflation should be mostly captured by July data. The annual core inflation rate, the gauge that strips out volatile items, was 10.9% in June, its lowest level since April 2016. That puts it well within the CB's target range of 13%. According to preliminary estimates, real GDP growth accelerated to 5.4% in FY 2018 which ended in June, from 4.3% in FY 2017. On 29 June 2018, the Executive Board of the IMF completed its third review of Egypt's economic reform programme supported by an arrangement under the Extended Fund Facility (EFF). The completion of the review allows the Egyptian authorities to draw the equivalent of SDR 1,432.76m (about USD 2.02bn), bringing total purchases to SDR 5,731.05m (about USD 8.06bn).

Davidia Zucchelli

In Russia, bank lending accelerated in April (+10.5% yoy from +5% in 2017) both in the corporate (+8.4% yoy from 2.8% in 2017) and the household (+16.6% from 12.7% in 2017) sectors. Domestic corporate lending, which accounted for around 74% of loans to the private sector, continued to be supported by international sanctions against Russia. A consequence is also the ratio of total large credit risks to own funds which remained very high, at over 200% as of May. After a long period of stability, NPL increased in May (from 10% as of December 2017 to 10.9% as of May). Deposits showed a strong performance (+9.9% yoy in April) both among corporates (9.5%) and households (10.2%). In line with official rates, interest rates on new loans to businesses declined to 8.66% in April (from 9.4% in December 2017), as did the interest rate on deposits from households (to 5.3% from 5.4%).

Thanks to favourable macroeconomic conditions, lending in Ukraine intensified its recovery (+7.6% yoy as of April from 0.9% in 2017) not only in the household sector (+12.7% yoy from 6.6% in 2017), but also among corporates (+6.4% from -0.4% in 2017). A high NPL rate (56.2% at the end of April) continues to limit lending growth, however. According to the CB, loans to non-defaulting borrowers are increasing by over 20% yoy. Furthermore, the strong increase in the household sector does not pose systemic risks for banks. Deposits increased by 11.3% (vs 12.1% yoy in 2017), both from corporates (11.7% in April from 13.7%) and households (11.1% from 11.4%) still supported by remittances.

In Egypt, loans and deposits grew by 7.6% and 24.4%, respectively, as of March (from 7.1% and 23.8% in 2017). But, in real terms, net of 13.3% inflation, changes remained negative in lending and over 10% in deposits. Deposits increased (+24.4% yoy) both from corporates (12.4%) and households (27.5%). The LTD ratio remained very low (34%, from 39.2% in December 2016). Lending interest rates on new business decreased to 18.3% in May (from 19.8% in December) and deposit interest rates fell to 12% (from 13.6% at end of 2017).

Country-Specific Analysis

Albania

Real Economy

Kledi Gjordeni

According to INSTAT data, the Albanian economy grew by 4.45% in 1Q18. In 1Q17, growth was 3.9%. The expansion in economic activity was mainly driven by growth in the industrial sector, in particular of electricity. In addition, in June 2018, the value of exports increased by 17.9% yoy, to LEK 27bn while the value of imports (LEK 54bn) decreased by 4.25%. The trade deficit fell to LEK 27bn, a decrease of almost 20.0% yoy. The expansion of aggregate demand has led to higher utilisation of production capacity, particularly in the labour market. The unemployment rate fell to 12.5% in 1Q18, and average wages increased by 2.3% in annual terms. Compared to 1Q17, the unemployment rate decreased by 1.7% (-0.9% qoq).

These cyclical developments are giving rise to domestic inflationary pressures. In June 2018, the annual rate of consumer price growth was 2.4% (vs a 1.9% average in 1Q17). The increase mainly related to prices of “Food and non-alcoholic beverages” and “Housing, water, electricity and other fuel”.

Financial Markets

Based on current trends, the CB expects further growth in economic activity and higher utilisation of production capacity on a medium-term horizon. These developments should contribute to a faster increase in wages and production costs, enabling the return of inflation to the target by the 2020. The current monetary policy stance is an important supporting factor for these developments. The historically low policy rate, of 1%, supports low financing costs; the programme of intervention in the domestic foreign exchange market helps to calm activity in the domestic foreign exchange market and prevents exchange rate appreciation.

The CB believes that the return of the policy rate to an upward trajectory will not begin before 2Q19. Also, the Supervisory Council views it to be necessary to continue the intervention programme in the domestic foreign exchange market.

Banking Sector

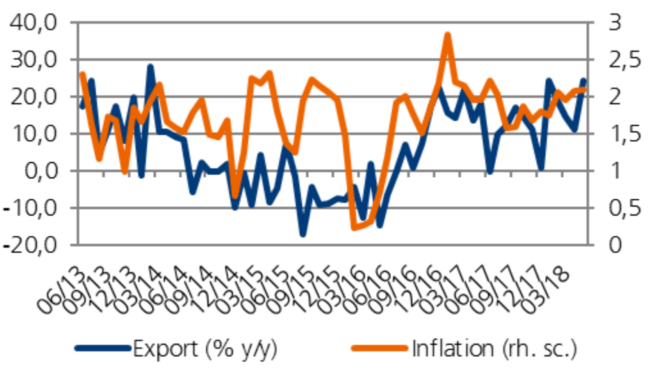
The most recent data on the banking sector, for May 2018, show total assets rose by 1.06% yoy. Total deposits decreased by 2.68% yoy. Household deposits contributed negatively by -3.62%, whereas corporate deposits continued to increase, by 2.09%. In May, total credit to the private sector increased by 0.93%. Corporate loan shrank by 3.28 yoy, whereas household loans continued to expand, by 4.26% yoy. The most recent data on the NPL rate, from May 2018, is 13.3 %.

Last macroeconomic indicators

%	Last value	1Q 2018	4Q 2017
Ind. production, wda yoy	n.a.	n.a.	n.a.
Export of goods, nominal yoy	18.0 (Jun)	19.0	8.7
Unemployment rate	n.a.	12.5	13.4
Inflation rate, average yoy	2.4 (Jun)	1.9	1.8
Loans (private sector, yoy, eop)	-0.9 (May)	0.2	0.5
Deposits (private sector, yoy, eop)	-2.7 (May)	-1.4	-1.3

Source: INSTAT, Central Bank of Albania

Export and inflation



Source: INSTAT

Bosnia and Herzegovina

Real Economy

Ivan Odrčić

GDP in 1Q18 increased by 2.0% yoy (growth for 4Q17 was revised downwards to +2.6%), reflecting strong growth in gross value added in wholesale and retail trade, transportation and accommodation activities (+7.1% yoy). Professional and administrative activities (-5.3% yoy) recorded the largest decline in value added. On a quarterly basis, GDP posted a 1.0% qoq growth rate, lower than in 4Q17 (+1.6%).

High frequency data for May show that the positive trends in the real sector continued, as industrial production output accelerated to 5.9% yoy (from 2.2% yoy in April) and real retail trade turnover advanced by 9.1%, amid rising employment and a falling unemployment rate. Goods exports, meanwhile, continued to be strong, showing double-digit growth rates in both May (+12.1% yoy) and June (+16.9%), which resulted in 1H18 exports growth of 12.0% yoy (o/w +13.5% yoy to EU member states).

Annual inflation in May rose to 1.3% (the highest inflation rate since January 2013) attributed to rising prices for transport (+8.3% yoy), tobacco products (+10.7% yoy) and electricity, gas and other fuels (+2.0% yoy). In the first five months of this year, the average inflation rate amounted to +0.9% yoy, o/w prices of food and non-alcoholic beverages rose by 1.0%, transportation by 5.3%, and housing, water, electricity, gas and other fuels by 2.0%.

Banking Sector

Ana Lokin

Growth of private sector loans continues to moderate gradually, slipping below 7% in May, to 6.7% yoy, driven by a deceleration in loans to non-financial corporations, to 6.4% yoy. Growth of loans to households continued to be strong, coming in at 7.1% yoy in May. The breakdown of household loans by purpose shows that the rise in consumer loans flat-lined at +7.8% yoy, whereas housing loans continued grow strongly, recording a 5.9% yoy increase.

Deposit growth continued in May, at a healthy at 9.0% yoy, though the increase in corporate deposits softened to 16.2% yoy, but household deposits expanded by 6.3% yoy. The latter is mostly due to a steeper increase in citizens' funds in transaction accounts (16.4% yoy), while the increases in local and foreign currency savings remained tepid, at 3.5% and 2.8% yoy, respectively.

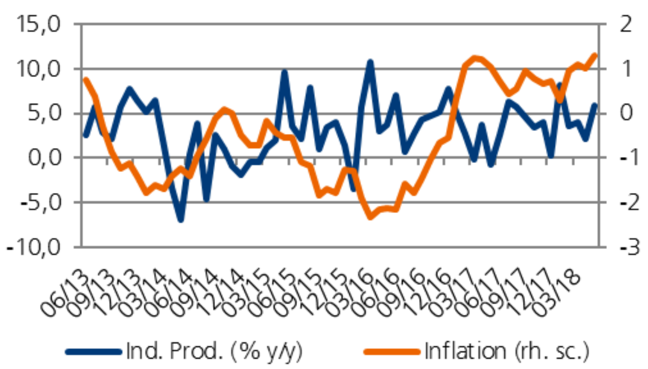
Positive trends in asset quality carried on in 1Q18, with the share of non-performing loans in total loans falling by 0.4pp qoq, to 9.7%. The share of non-performing loans in loans to legal entities narrowed by 0.6pp qoq, to 11.7%; in loans to households, it edged down by 0.1pp qoq, to 7.4%.

Latest macroeconomic indicators

%	Last value	1Q 2018	4Q 2017
Ind. production, wda yoy	5.9 (May)	5.2	2.5
Export of goods, nominal yoy	12.1(May)	12.1	15.7
Retail trade, real, wda yoy	9.1 (May)	5.3	4.4
Inflation rate, average yoy	1.3 (May)	0.8	0.7
Loans (private sector, yoy, eop)	6.7 (May)	7.3	7.3
Deposits (private sector, yoy, eop)	9.0 (May)	8.1	9.0

Source: BHAS, CBBH

Industrial production and inflation



Source: Labour and employment agency

Croatia

Real Economy

Ivan Odrčić

Industrial production continued on a negative trend in April-May (-0.9% yoy) while real retail trade continued to grow (+6.1% yoy) as a result of improving labour market conditions and higher consumer confidence. After declining by 3.2% yoy in 1Q, goods exports rebounded sharply in April (+15.7%), mostly due to higher exports of pharmaceuticals, ships and refined petroleum products. Data softened in May at +1.8% yoy (preliminary).

The annual inflation rate in June was 2.4%, the highest level recorded since April 2013, mostly due to rising crude oil prices on global markets (fuel prices +14.0% yoy); the 1H18 average annual inflation rate was 1.4%.

Financial Markets

Ana Lokin

The money market was quiet in June, as the average liquidity surplus of HRK 27bn kept interest rates stable. The average 3M Zibor rate remained unchanged mom, at 0.49%. The exchange rate in June saw mild appreciation pressures arising from FX inflows from tourism. The average EUR/HRK rate fell by 0.2% mom, to 7.38. The spread between the 10Y kuna government bond and Bund increased by 10bps mom in June, but due to a decline in the benchmark yield, the average 10Y kuna government bond yield remained unchanged mom, at 2.2%. Excess liquidity declined slightly in July, after the government bond settlement. But, rates remained static, due to thin demand, while the FX rate continued to be around 7.40. On 6 July, Fitch upgraded its outlook from stable to positive, which, however, had no impact on the government bond yield.

Banking Sector

In May, loans grew by 1.9% yoy as result of a 3.5% yoy increase in retail lending. The decline in corporate loans softened, to -0.4% yoy. Housing loan growth was fairly resilient to the worsening prospects related to the tightening of credit standards, a pleasant surprise, at 2.0% yoy. Cash loans rose sharply by towards +9.5% yoy, reflecting increasing household consumption. Deposit growth accelerated to 5.2% yoy in May, as corporate deposits continued to grow well, at +10.5% yoy, and household deposits grew by +3.6% yoy, both pushed upwards by a steep rise in funds on transaction accounts, due to flows related to the start of the tourist season.

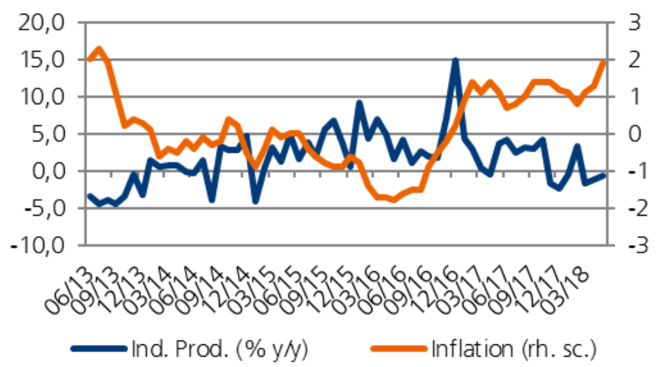
The share of NPL in 1Q18 remained static qoq, at 11.4%, as a 0.2pp rise in household loans (to 8.2%) was balanced out by a 0.2pp fall in corporate loans (to 22.0%). The rise of the share of NPL in retail portfolios is connected to a deterioration in the quality of cash loans (+0.5pp, to 6.5%), while in housing loans, the share remained at 6.2%. Regarding corporates, a decrease was recorded in almost all major activities (o/w trade was off 2.5pp, to 19.6%, construction was down 1.8pp, to 53.6%, manufacturing fell 1.6pp, to 17.4%, accommodation declined 2.9pp, to 10.2%), except for "other activities" (Agrokor), where the share soared by 14.5pp, to 34.3%.

Latest economic indicators

%	Last value	1Q 2018	4Q 2017
Ind. production, wda yoy	-0.6 (May)	0.3	0.0
Export of goods, nominal yoy	15.7 (Apr)	-3.2	9.3
Retail trade, real, wda yoy	7.9 (May)	3.1	3.3
ESI (index)	116.5 (Jun)	114.8	115.5
Inflation rate, average yoy	2.4 (Jun)	1.0	1.3
Loans (priv. sector, yoy, eop)	1.9 (May)	0.7	-0.1
Deposits (priv. sector, yoy, eop)	5.2 (May)	3.6	2.4

Source: CBS, EC, CNB

Industrial production and inflation



Source: EC

Czech Republic

Real Economy

Andrej Arady

The overall economic story has remained unchanged in Czech Republic recently, with the economy gradually decelerating towards potential after the stellar growth of 2018, but prices are growing fast. Industrial production is volatile, due to several one-off effects. On average, however, growth of industry is still above potential. The outlook for the upcoming months remains optimistic: the PMI in manufacturing bounced back to a very solid level of 56.8, overall business confidence has held up near its high. The pace of manufacturing growth should decelerate towards its potential in 2019. Judging from the strong growth of retail sales, private consumption has remained a reliable pillar of growth for the Czech economy through 2Q18. The economy enjoys full employment (with more jobs available than unemployed persons), which is pushing up wages (fastest growth in the past 15 years). The labour market is clearly overheating. In addition, we would note that the real estate market continues to boom. Prices continue to grow fast on every front. With regard to consumer inflation concerns, the rate rose in June for the third consecutive month, exceeding expectations, but still remaining within the CNB's tolerance band. The need of tighter monetary policy is thus still on the table.

Financial Markets

Regarding financial markets, the Czech koruna has basically not moved in response to the most recent interest rate hike in June. Its value continues to lag behind the fast-growing economy and productivity gains, dampening the effect of the foreign exchange channel as a transmisson mechanism of monetary policy. The CNB appears to view this as problematic. A weak koruna thus remains a risk factor regarding another rate hike in the near term. Longer term, we continue to believe that the koruna will align to its fair value, reflecting the solid performance of the economy and a higher interest rate environment relative to the Eurozone. Over the reminder of 2018, we expect to see one or possibly two (in case of a persistently weak koruna) more hikes, followed by another two in 2019.

Banking Sector

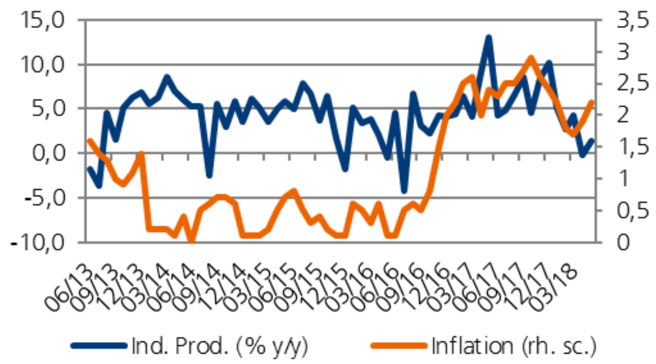
Along with the booming economy, the Czech banking market continues to grow strongly. The most recent credit standards survey already reflected the impact of the tighter regulation in the fast-growing mortgage market, however. In contrast to the mortgage market, credit standards for consumer loans eased further as a result of the positive economic outlook and the improved financial situation of households. Credit standards for non-financial corporations remained unchanged over the past quarter, supporting growth of investments. The banking sector is in a similar situation to the real economy: growth is gradually decelerating, but still remains high.

Latest economic indicators

%	Last value	1Q 2018	4Q 2017
Ind. production, wda yoy	1.4 (May)	4.0	7.7
Export of goods, nominal yoy	-2.2 (May)	-1.1	6.2
ECB refi rate	1.0 (20th Jul)	0.8	0.5
ESI (index)	109.8 (Jun)	109.9	108.4
Inflation rate, average yoy	2.6 (Jun)	1.9	2.6
Loans (priv. sector, yoy, eop)	5.1 (May)	5.5	6.5
Deposits (priv. sector, yoy, eop)	5.4 (May)	4.8	7.6

Source: CBS, EC, CNB

Industrial production and inflation



Source: EC

Egypt

Samer Halim

Real Economy

The IMF's third review regarding Egypt's reform programme stated that the macroeconomic outlook continues to appear favourable. GDP is expected to rise by 5.5% in FY 2018/19, supported by the recovery in tourism and natural gas production, with the Zohr gas field coming on line ahead of schedule. Also, the unemployment rate declined to 10.6%, the lowest level since 2011, and foreign reserves reached unprecedented levels (USD 44.26bn in June 2018). The current account balance continued to improve, with a sharp contraction of 57.5% in the deficit during the first nine months of FY 2017/18 yoy. Suez Canal revenues rose by 12%, tourism by 155%, and remittances by 23%. Egypt has achieved a primary budget surplus of 0.2% of GDP in FY 2017/18 and targets a primary surplus of 2% of GDP this year. In June 2018, the authorities increased fuel prices by another 44% on average, which raised the pre-tax price/cost ratios to about 73% for gasoline, diesel, kerosene and fuel oil. Additional increases are planned to achieve the objective of full cost recovery by the end of FY 2018/19.

Financial Markets

Annual urban consumer inflation increased to 14.4% in June 2018 from 11.4% in May, the first increase after 10 months of steady decline. Additionally, monthly urban consumer inflation rose to 3.5% in June 2018 from 0.2% in May. This was due to the rises in fuel and electricity prices in June. Headline inflation is expected to remain in line with the CBE's target announced in May 2017, namely 13% (±3%) in 4Q18. Single-digit inflation is expected to be reached after the temporary effect of supply shocks dissipates. On 28 June, the MPC decided to keep the overnight deposit and overnight lending rates at 16.75% and 17.75%, respectively. As to exchange rates, the Egyptian pound has remained broadly stable, with modest depreciation in recent weeks associated with the recent volatility in capital flows to some emerging markets.

Banking Sector

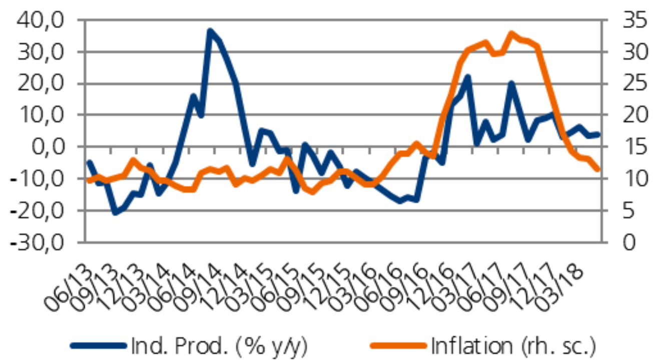
In March 2018, total loans rose about 15% yoy, to EGP 1.54tn. Government loans rose significantly, by more than 40%, to fund the ongoing mega projects, while private loans achieved a modest growth rate, of 7.6%. Egyptian banks are still the main buyer of government securities: their investments in securities and TBs have increased continuously since 2011, reaching EGP 166tn in March 2018. Total deposits climbed by 21.5%, to EGP 3.48tn: government and private deposits rose by 9.3% and 24.4%, respectively. According to the IMF's third review of Egypt's reform programme, the country's banking system remains liquid, profitable, well capitalised, and resilient to moderate shocks. Most banks maintain solid liquidity buffers and actively manage their balance sheets to mitigate interest rate and liquidity risks from large holdings of government securities. The capital adequacy ratio for the banking sector rose to 15.7% in March 2018 compared to 15.2% in Dec. 2017, and NPLs declined to 4.5% from 4.9%. The authorities are undertaking a review with the IMF of the CBE Law with the aim of submitting draft amendments to the cabinet by end-Sep. 2018 (initially planned for end-June).

Latest economic indicators

%	Last value	1Q 2018	4Q 2017
Ind. production, wda yoy	3.8 (May)	4.7	9.2
Nom. exports yoy	7.4 (Mar)	21.6	21.6
Retail sales yoy	n.a.	n.a.	n.a.
Inflation rate yoy	14.4 (Jun)	14.9	26.2
CB reference rate	16.8 (20th Jul)	16.8	18.8
Loans (priv. sector, yoy, eop)	7.6 (Mar)	7.6	7.1
Deposits (priv. sector, yoy, eop)	24.4 (Mar)	24.4	23.8

Source: Ministry of Industry & Foreign Trade, Central Bank of Egypt, HSBC

Industrial production and inflation



Source: Ministry of Planning, CAPMAS

Hungary

Real Economy

Sandor Jobbagy

Industrial production and exports in Hungary recorded a relatively weak performance in May, following a brief pick-up in the preceding month. Industry grew by 0.4% in May, but the raw figure was largely driven by the calendar effect, as the adjusted data posted 3.8% growth yoy. PMIs and other forward-looking indicators were slightly below their historical peaks, with all the most recent figures showing some reacceleration following troughs recorded in the March-May period. This continues to imply further robust growth for 2018. The GDP growth rate in 1Q18 (4.4% yoy) also underpinned this outlook. Economic growth was kept being boosted by market-based services. On the other hand, EU funds remain a strong driver of growth amid accomodative fiscal and monetary policy. Wage growth has remained in double-digit territory, with an 11.2% rise in May. Headline inflation jumped from 2.8% to 3.1% in June, which was the highest reading in more than five years, breaking through the mid-point of the NBH 3% +/- 1pp target. Inflation was primarily driven by oil prices and the base effect, but the forint and wages also point to increasing inflation risks. External and internal balances look set to remain in good shape, though the fiscal balance improvement of the preceding years appears to have ceased this year.

Financial Markets

The 3M policy rate of the central bank (NBH) was left on hold at 0.90% through 1H18 (as was the case in 2017), as was the more functional O/N depo rate (-0.15%). Market players are increasingly speculating about the timing of the end of the current easing phase. This process has been boosted by the forint's depreciation since May/June. While the central bank offered more cautious messages in its most recent statements, monetary easing continues, the NBH is maintaining the new swap programme, and mortgage bond purchases of a significant scale have continued since January 2018. The significant rise of BUBOR rates and, partly, of longer yields stopped or slowed down in tandem with the partial positive correction of the forint (still above EUR/HUF 320 in June/July). The 10Y spread vs German yields has remained close to 300bps. The main reason for the market shift was the deterioration of global EM sentiment, but the low Hungarian rates may also have started to play a role compared to the situations for regional peers.

Banking Sector

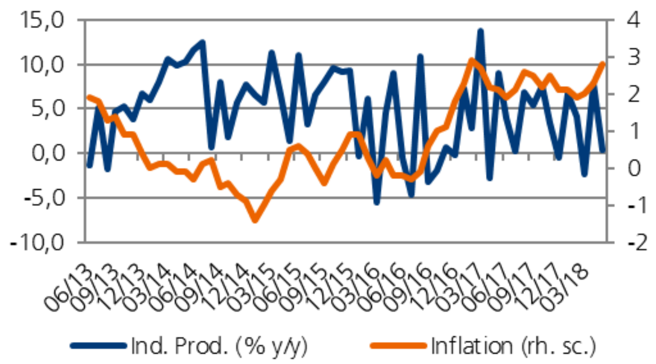
Hungary's banking sector continued to perform very well with regard to lending activity in 2Q18 amid the ongoing strengthening of domestic consumer confidence and demand. Growth looks set to continue through this year and may even beat current expectations, though it probably won't exceed 2017's rise. Some loan segments (including mortgage and personal loans) are showing especially dynamic pickups. Asset quality continues to improve, with NPLs already below 5%. The sector has continued to reflect strong liquidity and strong capital positions.

Latest economic indicators

%	Last value	1Q 2018	4Q 2017
Ind. production yoy	0.4 (May)	2.8	3.5
Nom. exports yoy	0.0 (May)	3.8	7.0
ESI (index)	123.0 (Jun)	120.6	120.8
Retail sales yoy	7.2 (May)	7.7	5.8
Inflation rate yoy	3.1 (Jun)	2.0	2.3
CB reference rate	0.9 (20th Jul)	0.9	0.9
Loans (priv. sector, yoy, eop)	7.0 (May)	5.1	6.0
Deposits (priv. sector, yoy, eop)	14.7 (May)	13.4	10.8

Source: CSO, NBH, Bloomberg

Industrial production and inflation



Source: CSO

Poland

Real Economy

Sandor Jobbagy

Forward-looking indicators regarding the Polish economy remained little changed in May-June, staying close to the highest levels recorded since the end of the global crisis. The EU Economic Sentiment Indicator was 109.9 in both May and June. Hence, expectations still point to strong future growth. The dynamics of industrial production partly recovered in June (+6.8% yoy), but are still lagging behind growth rates seen in 1Q18. Overall economic growth, however, continued to accelerate, reaching 5.2% in 1Q18, supported by relatively strong private consumption. Investments were also switching to higher growth, partly due to a comparison with previous low flows. Judicial reforms and conflicts with the EU have so far not had an adverse impact on overall GDP growth and the outlook. Fiscal policy remained under control, as shown by the annual deficit. We expect to see some decrease in GDP growth in 2018, but with similar average growth to that recorded in 2017 (4.4% after 4.5%). Domestic demand and rising wages are having a limited impact on inflation so far: while CPI rose in May in 2Q18, the headline figure did not move above 2%. We expect a minimal further rise in 2H18, with the average remaining closer to 2%.

Financial Markets

In 1H18, the NBP left its policy rate unchanged at 1.50%, similar to the whole of 2017. However, the most recent monetary decisions and comments as well as market expectations suggest a rising probability of a tightening cycle starting at the end of this year or early in 2019. The approaching end of the ECB's QE programme also supports these expectations. The central bank is concerned about food price growth, which has been on the rise since the end of last year, and also about accelerating wage growth. Despite the current monetary expectations, the zloty weakened in June and July, due to the decline in global EM sentiment. The second half of July saw some correction: the EUR/PLN exchange rate returned to below 4.35, down from this year's peak above 4.40, with a potential return to the 4.20-4.25 range later in 2018.

Banking Sector

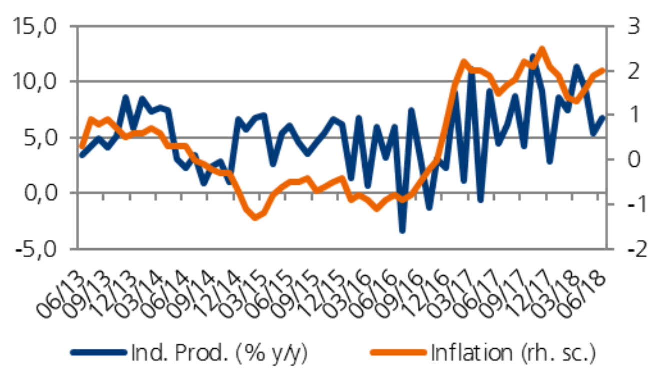
Despite having the highest loan/deposit ratio in the CEE region, Polish lending dynamics have remained strong recently. This is likely to produce stronger results compared to the previous year in tandem with the improved GDP growth outlook, fueled by consumption. Loan stocks to the private sector showed persistent rises, and the overall annual growth rate of loan stock was above 3%. Deposit volumes also continued to increase, and these are likely to maintain momentum through 2018, despite relatively low (though not decreasing) interest rates. The quality of the banking sector's entire loan portfolio remained solid, with low average NPL ratios. The banking sector is likely to experience further consolidation, as the sector's concentration is viewed as being too low.

Latest economic indicators

%	Last value	1Q 2018	4Q 2017
Ind. production yoy	6.8 (Jun)	9.1	8.1
Nom. exports yoy	3.7 (Apr)	0.8	4.3
ESI (index)	109.9 (Jun)	110.0	106.7
Retail sales yoy	4.8 (May)		
Inflation rate yoy	2.0 (Jun)	1.5	2.2
CB reference rate	1.5 (20th Jul)	1.5	1.5
Loans (priv. sector, yoy, eop)	5.8 (May)	4.5	3.2
Deposits (priv. sector, yoy, eop)	5.5 (May)	4.7	3.7

Source: CSO, NBH, Bloomberg

Industrial production and inflation



Source: CSO

Romania

Real Economy

Sebastian Maneran

Domestic high frequency economic indicators show a change in growth drivers for 2Q18 from domestic consumption to investments and external demand. May 2018 industrial production, at +3.6% yoy on seasonally adjusted data, points to robust external demand, as industry manages to stay in positive territory even after the double-digit growth pace seen in 2017. June 2018 headline inflation was 5.40% yoy, slightly below that of April 2018, at 5.41% yoy, and below the 5.50% yoy market expectations. Given the statistical base effects set in 2017, headline inflation in 2H18 is expected to start to decline. Export growth at the end of 5M18 was +8.8% yoy, ie, slowly closing the gap with import growth which was +9.3% yoy vs export growth of 9.1% in 2017 and import growth of 12.2% in 2017.

Financial Markets

The exchange rate remained stable, albeit at historical high levels, fluctuating around 4.65 RON/EUR. The low EUR/RON volatility was noteworthy in a general international environment dominated by rising interest rates in core markets that encouraged capital outflows from emerging economies.

Higher RON interest rates managed to shelter the Romanian financial markets from the volatility induced by the above-mentioned external factors. Notwithstanding this, at the latest rate setting meeting, the Romanian central bank paused the tightening cycle, keeping the policy rate at 2.50%, as 1Q18 growth data showed a deceleration in domestic demand and as trending lower consumer sentiment feeds into inflation expectations in 2H18, accentuating the statistical base effects. Hence, the growth pace of short-term rates slowed to a 2.97% average in June 2018 from a 2.70% average in May 2018 (2.18% in April 2017).

Banking Sector

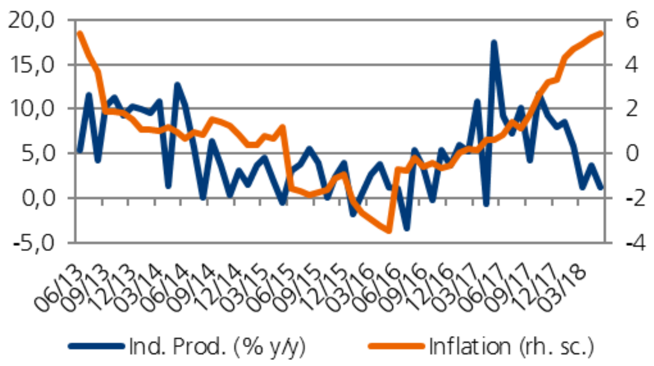
Data show that asset quality continued to improve in 2018, with the NPL ratio in May 2018 printing 6.16% from 6.40% in December 2017, while the coverage ratio continues to stay close to 60%, well above the 40% EBA threshold. Private sector loan data continue to show robust growth in local currency lending, to more than RON 239bn, driven primarily by housing loans. We note that the robust growth comes in an environment of rising interest rates for local currency credit, with May 2018 data showing the lending rate in the economy passing the 7% threshold (7.08%), while foreign currency lending rates actually decreased, to 2.47% on average in May 2018 from 2.68% in April 2018. On the liabilities side, changes were subdued, with the local currency deposit rate nudging higher, to 1.64% in May 2018 from 1.33% the previous month while the foreign currency deposit rate was only a whisker lower in May 2018, at 0.23% (from 0.24% the previous month).

Latest economic indicators

%	Last value	1Q 2018	4Q 2017
Ind. production yoy	1.2 (May)	5.2	9.6
Nom. exports yoy	5.2 (May)	10.0	8.8
ESI (index)	101.5 (Jun)	101.4	103.8
Retail sales yoy	6.4 (May)	6.7	12.9
Inflation rate yoy	5.4 (Jun)	4.7	3.1
CB reference rate	2.5 (20th Jul)	2.3	1.8
Loans (priv. sector, yoy, eop)	6.4 (May)	6.1	5.6
Deposits (priv. sector, yoy, eop)	10.4 (May)	10.6	10.4

Source: National Statistical Institute, NBR

Industrial production and inflation



Source: NBR

Russia

Real Economy

Irina Lekareva

According to preliminary estimates of the Ministry of Economic Development real GDP growth in Q2 accelerated to 1.8% yoy from 1.3% yoy in Q1, benefiting from the recovery of construction activity (+1.9% vs. -3.2% in Q1) and the acceleration in mining (+2.2% vs. +1.5%) and manufacturing (+4.3% vs. +3.7%) activities. The increase of GDP in Q2 came despite the slowdown of GDP estimated in June (1.1%, below the Q2 average of 1.8%) in parallel with a slowdown recorded by industrial production (2.2%, again below the Q2 average of 3.3%). Retail sales growth was stronger as well in Q2 (+2.7% vs. +2.4% in Q1) boosted by low inflation.

Annual inflation in general has corresponded to the CBR's expectations. Inflation in June fell to 2.3% yoy but inflation expectations are now moving upwards, due to higher petrol prices and a planned VAT increase. According to CBR estimates, the VAT increase in 2019 will make about a 1% contribution to inflation. Part of this effect may be seen this year.

Financial Markets

On 15 June 2018, the CBR kept the key rate at the current level of 7.25%. Taking into account the impact of the planned tax measures on inflation and expectations, the transition to neutral monetary policy is expected to be slower than previously thought. The CBR expects the transition to neutral monetary policy to occur next year, once the influence of all risks will have been recognised and identified. While the key interest rate is likely to be lowered further, that is more likely to occur in 2019. We believe that CBR will leave the key rate unchanged this year or at most will cut it to 7.00% around the end of the year.

After the period of RUB volatility in April, positive dynamics for the oil market and favourable macroeconomic conditions provided support to the exchange rate in the following months. In June, EM currencies weakened by about 3% against the USD. The RUB lost 1.88% in value against the USD and is expected to stabilise at the current level.

Banking Sector

The volume of loans to the private sector is increasing at a good pace. Household lending continues to accelerate (+16.6% yoy in April) and significantly has outstripped the volume of corporate lending (+8.4% yoy in April).

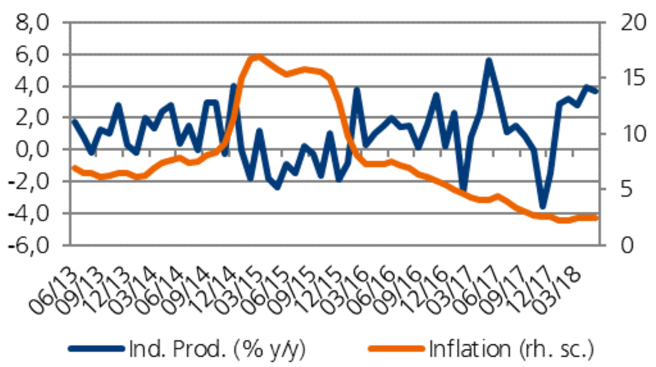
Deposits by households continue to grow steadily (+8.7% yoy in March, +10.1% yoy in April). Corporate deposits have also shown a positive trend, but with more volatile dynamics (+6.3% yoy in March, +9.2% yoy in April). Interest rates on banking operations have recorded a downward trend. The share of NPL remains relatively stable (10.6% in April).

Latest economic indicators

%	Last value	1Q 2018	4Q 2017
Ind. production yoy	2.2 (Jun)	3.0	-1.7
Nom. exports yoy	29.2 (May)	23.3	24.5
Retail sales yoy	3.0 (Jun)	2.2	3.0
Inflation rate yoy	2.3 (Jun)	2.3	2.6
CB reference rate	7.3 (29th Jun)	7.3	7.8
Loans (priv. sector, yoy, eop)	10.5 (Apr)	8.9	5.2
Deposits (priv. sector, yoy, eop)	9.9 (Apr)	7.7	8.1

Source: State Statistics Federal Service, Central Bank of Russia

Industrial production and inflation



Source: State Statistics Federal Service

Serbia

Real Economy

Marija Savic

According to NBS estimates, real GDP rose by 4.1% yoy in 1H18, suggesting economic growth of around 3.6% in 2Q18, following the confirmed 4.6% yoy result achieved in 1Q18. The economic outlook remains positive, with the full-year GDP figure projected at 3.8% yoy for 2018. Economic activity is strongly supported by private consumption, a more expansionary fiscal policy, and increased investments driven by the public investment cycle.

After recording this year's low of 1.1% in April 2018, yoy inflation started to accelerate, reaching 2.3% in June. The base effect that was playing an important role in the final CPI result during the first months of 2018 has disappeared. Core inflation amounted to 0.8% yoy in June, for the fourth consecutive month (the lowest level since inflation was measured). Looking ahead, inflation is expected to oscillate around the current levels, moving more meaningfully towards target around the turn of the year. Favourable fiscal trends continued, with a budget surplus of RSD 8.8bn achieved and a primary surplus of RSD 64.8bn in first five months of the year. The IMF approved a new cooperation programme supported by the Policy Coordination Instrument for Serbia in July 2018 which envisages a fiscal policy focused on further lowering public debt, increasing capital spending to address Serbia's infrastructure needs, and some reduction of the tax burden on labour and business.

Financial Markets

In July 2018, the NBS kept the key policy rate unchanged for a third month in a row. Since the beginning of the year, the key rate has been cut twice by total of 0.5pp, and stands at 3.0% as of April, its lowest level during the inflation targeting regime. The CB is likely to keep the key policy rate flat for the rest of the year, with the next move (a hike) around the middle of 2019. The dinar has been under appreciation pressures since the beginning of the year hovering around the 118 mark. During 1H18, the NBS bought a total of EUR 1,370m and sold EUR 180m on the FX market in order to smooth appreciation pressures. In July (until the 24th), it bought EUR 150m. Dinar appreciation largely reflects the increased confidence in Serbia's improved macroeconomic fundamentals, sustained strength in net FDI inflows, stronger goods exports, soaring remittances, and higher non-resident investment in dinar securities.

Banking Sector

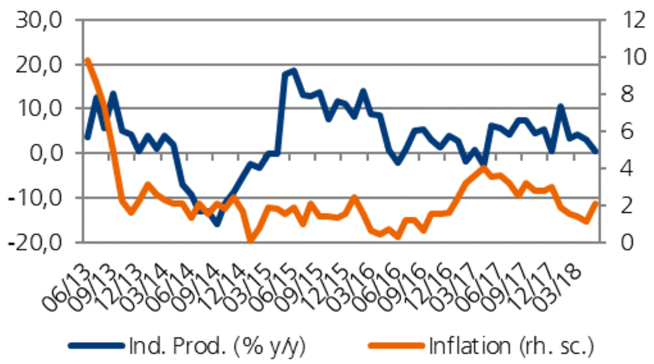
The NBS published final banking sector results for 2017. The overall profit before tax of all 29 banks in Serbia amounted to RSD 68.7bn in end-2017, which is RSD 47.39bn higher compared to end-2016. A profit was recorded by 22 banks while seven recorded losses. The increase in profitability was predominantly driven by a decrease in credit losses caused by NPL (by RSD 33bn), and by consolidation and acquisition of banks in the sector. The most recent data show that lending has continued on an upward trend, accelerating to 4% yoy in May 2018. Positive trends in domestic lending are expected to continue as a result of relaxed monetary policy, an acceleration of economic activity, reduced NPL (currently at 8.6%), low interest rates in the Euro area, and interbank competition.

Latest economic indicators

%	Last value	1Q 2018	4Q 2017
Ind. production yoy	0.5 (May)	6.0	3.5
Nom. exports yoy	5.1 (May)	9.9	7.9
Retail sales yoy	3.5 (May)	3.4	2.3
Inflation rate yoy	2.3 (Jun)	1.6	2.9
CB reference rate, eop	3.0 (20th Jul)	3.3	3.5
Loans (priv. sector, yoy, eop)	3.9 (May)	2.2	2.1
Deposits (priv. sector, yoy, eop)	5.9 (May)	3.0	3.1

Source: Statistical Office, National Bank of Serbia

Industrial production and inflation



Source: Statistical Office, National Bank of Serbia

Slovakia

Real Economy

Andrej Arady

Slovakia continues to grow well, with a high inflation profile. Activity in manufacturing accelerated in the first two months of the second quarter from its average growth in the first quarter. This acceleration was driven primarily by car production, which should accelerate even further in the rest of the year thanks to rising production capacity. Similar to neighbouring economies, activity outside manufacturing has remained solid, but decelerating from previous stellar growth. Construction output posted nearly 4.0% yoy average growth in the first two months of the second quarter vs 12% yoy in 1Q18. Retail sales meanwhile decelerated from 4.8% yoy in 1Q18 to 3.2% in April-May.

The outlook though remains positive. Economic sentiment, the labour market, and EU-funded investments have remained supportive, as has the ECB's monetary policy which is for Slovakia specifically more accommodative than needed at this stage of the economic cycle.

Inflation bounced back to close to 3% in June, primarily due to increases of oil prices and a rising demand-sensitive component. The labour market in the meantime continues to tighten. The decrease in the registered unemployment rate visibly decelerated in the past months even though the number of jobs continues to increase. The key issue for companies is to find employees with appropriate skills which further impacts wage growth.

Financial Markets

Yields on Slovak government bonds continue to be heavily impacted by the ECB's asset purchase programme (APP). The spread vs benchmark German Bunds slipped back below 50bps which is still far off pre-APP period. Nevertheless, we keep our forecast of increasing spread to 60-80bps along with programme ECB's QE termination. Yields on German Bunds alone in the meantime remains extremely low.

Banking Sector

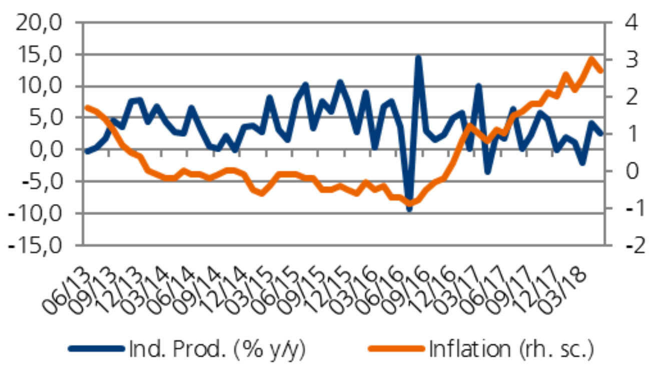
The banking sector's performance continued the trends seen in previous months. The growth of loans is gradually decelerating (due to tighter regulation), but still remains very high, from double-digit readings in the previous year to below 9% yoy in May. Deposits, in contrast, supported by increasing household income, continue their uptrend, as expected, currently growing above 6% yoy vs 3.3% yoy a year ago. Interest rates remain at historical lows.

Latest economic indicators

%	Last value	1Q 2018	4Q 2017
Ind. production, wda yoy	2.5 (May)	0.4	3.5
Nom. exports, yoy	7.3 (May)	3.9	7.1
ESI (index)	102.9 (Jun)	103.0	103.3
Retail sales, yoy	3.5 (May)	4.8	5.7
Inflation rate, yoy	2.9 (Jun)	2.4	2.0
ECB refi rate	0.0 (20th Jul)	0.0	0.0
Loans (priv. sector, yoy, eop)	8.9 (May)	9.3	9.6
Deposits (priv. sector, yoy, eop)	6.4 (May)	6.0	5.2

Source: Statistical Office of the Slovak Republic, National Bank of Slovak Republic

Industrial production and inflation



Source: Statistical Office of Slovak Republic

Slovenia

Real Economy

Ivan Odrčić

After declining by 0.7% in April, real retail trade rebounded strongly in May, increasing by 3.8% yoy, primarily driven by higher retail sales of fuels in specialized stores (+12.6%). In the same period, Industrial production advanced by 6.0% yoy, fueled by supportive foreign demand and high confidence in the sector, while goods exports rose by 10.1% yoy. The labour market in May remained favourable, as the number of employed increased by 3.0% yoy and the unemployment rate fell to 12.5% yoy (albeit more slowly than in the previous months).

Inflationary pressures intensified slightly in June (+2.3% yoy vs +2.2% in May), while in 1H18, the average annual inflation rate (measured by HICP) amounted to 1.8% (o/w) (housing prices rose the most, at +3.7% yoy).

Financial Markets

Ana Lokin

Short-term rates barely moved in June, with an average 3M Euribor at -0.32%. Average 10Y government bond yields flat-lined in June, at 1.1%, as a 10bps mom rise in the spread with Bunds was offset by a dip in the benchmark yield. Average 5Y CDS spreads in June inched up by 5bps mom, to 65bps. In July, the yield was down to 0.9%, following the benchmark, whereas CDS spreads and the 3M Euribor remained unchanged.

Banking Sector

Lending continued to rise in May, with private sector loans expanding by 2.7% yoy. Loans to non-financial corporations decreased by 0.8% yoy, and by 0.6% mom, reflecting the growing use of alternative sources of funding. A strong rise in household loans continued, at 6.2% yoy. Housing and consumer loan growth rates rose to 4.0% and 11.5% yoy, and other loans to 7.0% yoy. The rise in deposits continued, in line with economic growth, accelerating to 7.7% yoy in May on account of a 12.1% yoy surge in corporate deposits, followed by a 6.2% yoy increase in household deposits. Growth of overnight deposits edged up, to 12.9% yoy, while the decline of term deposits moderated to -4.3% yoy.

The quality of assets continued to improve in 2018, with share of non-performing claims on banks' balance sheets down to 3.2% at end-1Q18, -0.4pp qoq, as the share in the corporate portfolio fell by 0.3pp qoq, to 5.0% (construction -1.3pp qoq, to 18.7%, real estate -2.2pp qoq, to 5.6%, trade -0.1pp qoq, to 4.0%), while in the household portfolio stood this share remained at 2.6%. The broader NPE ratio (EBA definition) dropped by 0.6pp qoq, to 5.4%.

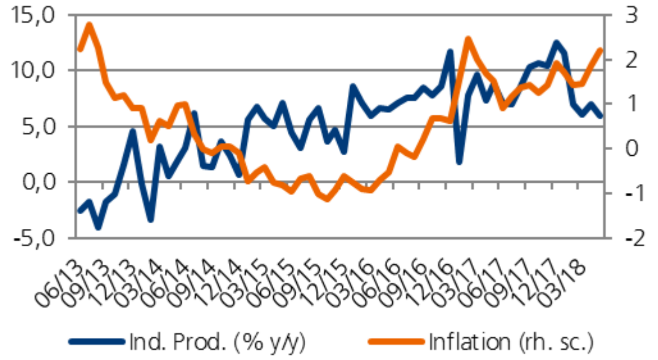
In July, the Slovenian government initiated the privatization process for the largest domestic bank, NLB, which is 100% owned by the state, with plans to sell at least 50% plus one share at IPO by year-end, and a remaining stake of up to 75% minus one share by the end of 2019.

Latest economic indicators

%	Last value	1Q 2018	4Q 2017
Ind. production, wda yoy	5.9 (May)	8.2	11.2
Nom. exports yoy	13.8 (Apr)	10.8	15.1
ESI (index)	113.6 (Jun)	113.3	117.2
Consumer confidence indic.	0.9 (Jun)	1.5	0.2
Inflation rate yoy	2.3 (Jun)	1.5	1.5
ECB refi rate	0.0 (20th Jul)	0.0	0.0
Loans (priv. sector, yoy, eop)	2.7 (May)	2.8	3.2
Deposits (priv. sector, yoy, eop)	7.7 (May)	6.1	7.0

Source: Statistical Office of the Republic of Slovenia, National Bank of Slovenia

Industrial production and inflation



Source: Statistical Office of the Republic of Slovenia

Ukraine

Real Economy

Giancarlo Frigoli

In its July inflation report, the NBU said it expects real GDP growth to accelerate to 3.4% in 2018 (unchanged from the previous forecast released in March). Economic growth will continue to be largely driven by private consumption, which has been fueled this year by rapid growth in wages, remittances and pensions. Investment activity is also expected to remain high. Favourable terms of trade, a recovery in the industrial sector, and the greater access of Ukrainian exporters to foreign markets will help to decrease the negative contribution of net exports to GDP. In 2019, however, economic growth will decelerate to 2.5% (below the previously forecast 2.9%). This will be a result of a more prudent fiscal policy which is necessitated by large repayments of public debt. Furthermore, tight monetary conditions that are necessary to bring inflation back to target will affect growth. In 2020, the real economy is expected to grow by 2.9%. According to preliminary estimates by the central bank, real GDP growth in 2Q18 was 3.2%, slightly up compared to the 3.1% recorded in 1Q18.

Financial Markets

The NBU has kept its inflation forecast for year-end 2018 unchanged at 8.9% (9.9% was inflation in June), whereas the core inflation projection was lowered to 7.1% (9% estimated in June). A faster-than-expected inflation slowdown in May-June 2018 should be offset in the second half of this year by a few inflation factors, including a greater-than-anticipated increase in administered prices which is expected at the end of the year, as domestic gas prices are being brought closer to the import parity price. Tariff increases also influenced inflation levels in the first three quarters of the next year, which will not allow the NBU to bring inflation to the target range before 4Q19. At the same time, in 2H18 and 2019, a number of factors of a more fundamental nature, as distinct from the rise in administered prices, will affect inflation.

Banking Sector

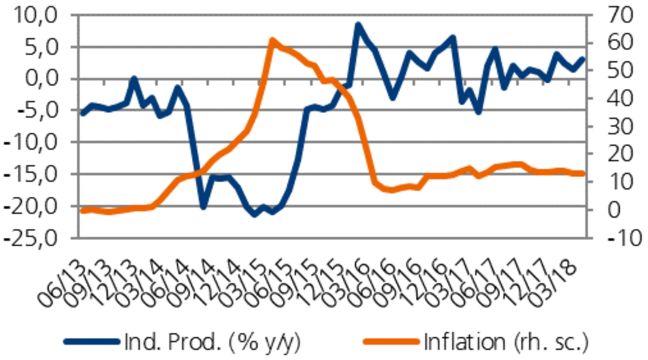
Davidia Zucchelli

Thanks to favourable macroeconomic conditions, lending in Ukraine intensified its recovery (+7.6% yoy as of April from 0.9% in 2017) not only in the household sector (+12.7% yoy from 6.6% in 2017), but also among corporates (+6.4% from -0.4% in 2017). A high NPL rate (56.2% at the end of April) continues to limit lending growth. According to the CB, loans to non-defaulting borrowers are increasing by over 20% yoy. Almost two-third of NPL are concentrated in state-owned banks (including Privatbank), with 14% in Russian banks. Furthermore, the strong increase in the household sector does not pose systemic risk for banks. Deposits increased by 11.3% (vs 12.1% yoy in 2017), both from corporates (11.7% in April from 13.7%) and households (11.1% from 11.4%), still supported by remittances. Bank returns in 1Q18 amounted to UAH 8.7bn (ROE of 22.3%), thanks to high operating income and a significant drop in provisioning. Provisions represented more than 80% of NPL as of December 2017 and the very high NPL ratio cast doubts on the opportunity of dropping them.

Latest economic indicators

	Last value	1Q 2018	4Q 2017
Ind. production yoy	2.5 (May)	3.6	0.8
Nom. exports yoy	12.9 (May)	17.0	20.2
PMI manufacturing	n.a.	n.a.	n.a.
Retail sales	4.9 (May)	7.6	9.0
Inflation rate yoy	9.9 (Jun)	13.8	14.0
CB reference rate	17.5 (20th Jul)	17.0	14.5
Loans (priv. sector, yoy, eop)	7.6 (Apr)	6.6	0.9
Deposits (priv. sector, yoy, eop)	11.3 (Apr)	10.7	12.1

Industrial production and inflation



Source: State Statistic Service of Ukraine

Country Data: Economy, Markets and Banks - the economic cycle

Economy

	GDP chg yoy			Ind. Prod[1]. chg.yoy			Export nom. ch yoy			Inflation chg yoy				FX reserves chg (mln €)[2]			CA bal. (mln €)[3]	
	1Q18	4Q17	2017	Last	mth	1Q18	Last	mth	1Q18	Last	mth	1Q18	2017	1Q18	4Q17	2017	1Q18	4Q17
CEE																		
Czech Rep.	4.3	5.5	4.3	1.4	May	4.0	-2.2	May	-1.1	2.6	Jun	1.9	2.5	-163.8	-393.8	46256	2310	-26.8
Hungary	4.4	4.4	4.0	0.4	May	2.8	0.4	May	3.8	3.1	Jun	2.0	2.4	-984	1174	-3858	3603	197
Poland	5.2	5.1	4.5	6.8	Jun	9.1	3.7	Apr	0.8	2.0	Jun	1.5	2.0	3888	1291	-7143	378	-578
Slovakia	3.6	3.5	3.4	2.5	May	0.4	7.3	May	3.9	2.9	Jun	2.4	1.4	n.s.	n.s.	n.s.	n.s	n.s
Slovenia	4.6	6.0	5.0	5.9	May	8.2	13.8	Apr	10.8	2.3	Jun	1.5	1.6	n.s.	n.s.	n.s.	663	532
SEE																		
Albania	4.4	3.4	3.7	n.a.	n.a.	n.a.	18.0	Jun	19.0	2.4	Jun	1.9	2.0	-142	215	n.a.	-165	-295
Bosnia H.	2.0	2.6	2.6	5.9	May	5.2	12.1	May	12.1	1.3	May	0.8	0.8	n.a	182	524	n.a	-281
Croatia	2.5	2.2	2.9	-0.6	May	0.3	16.1	Apr	-3.2	2.4	Jun	1.0	1.1	774	752	2192	-1902	-583
Romania	4.0	6.7	6.9	1.2	May	5.2	5.2	May	10.0	5.4	Jun	4.7	1.3	2480	305	3895	-967	-6295
Serbia	4.6	2.4	1.9	0.5	May	6.0	5.1	May	9.9	2.3	Jun	1.6	3.2	551	-744	-689	-650	-677
CIS MENA																		
Russia	1.3	0.9	1.5	2.2	Jun	3.0	29.2	May	23.3	2.3	Jun	2.3	3.7	21236	5157	38476	28800	13698
Ukraine	3.1	2.2	2.5	2.5	May	3.6	12.9	May	17.0	9.9	Jun	13.8	14.5	9	747	3688	-567	-931
Egypt	5.4	5.3	5.0	3.8	May	4.7	7.4	Mar	21.6	14.4	Jun	14.9	29.6	5591	485	12755	-1930	-1785
m.i. E. A.	*2.5*	*2.7*	*2.4*	*2.4*	*May*	*3.1*	*-0.9*	*May*	*2.8*	*2.0*	*Jun*	*1.3*	*1.5*					

Source: Datastream, Reuters; [1]Wda data for Slovakia, Slovenia; Bosnia, Croatia, Egypt; [2]USD for Russia, Egypt, Ukraine, Romania; [3]USD for Russia, Egypt, Ukraine

Markets and Ratings

	S/T rates[1]		L/T rates[2]		Foreign exchanges[3]			Stock markets		CDS spread (bp)		Rating
	18/07	chg bp 3M	18/07	chg bp 3M	18/07	3M chg%	1Y chg%	3M chg%	1Y chg%	18/07	18/04	Moody's
CEE						Vs Euro						
Czech Rep.	0.9	0.0	1.9	0.3	25.8	2.1	-0.9	-3.7	7.9	35.2	33.7	A1
Hungary	0.3	0.2	3.5	1.1	323.9	4.4	5.6	-10.4	-3.3	82.0	77.8	Baa3
Poland	1.8	0.0	3.1	0.1	4.3	3.3	2.4	-6.7	-9.5	60.3	41.5	A2
Slovakia	-0.3	0.0	0.7	-0.1	Euro	Euro	Euro	1.5	3.4	41.5	40.2	A2
Slovenia	-0.3	0.0	0.9	-0.1	Euro	Euro	Euro	5.4	10.3	60.6	52.3	Baa1
SEE												
Albania	1.2	0.0	n.a.	n.a.	126.1	-2.5	-4.9	n.a.	n.a.	n.a.	n.a.	B1
Bosnia H.	n.a.	n.a.	n.a.	n.a.	1.96	Board	Board	n.a.	n.a.	n.a.	n.a.	B3
Croatia	0.5	0.0	2.2	-0.1	7.4	-0.4	-0.4	0.4	-2.6	93.3	94.8	Ba2
Romania	3.2	1.3	5.0	0.6	4.7	0.0	2.1	-10.6	-2.7	82.5	79.0	Baa3
Serbia	3.0	0.0	n.a.	n.a.	118.0	-0.2	-2.2	0.9	14.7	109.8	119.5	Ba3
CIS MENA						Vs USD						
Russia	7.5	0.0	7.7	0.3	62.4	2.1	5.7	2.3	21.9	123.8	124.6	Ba1
Ukraine	18.2	0.1	14.5	0.0	26.2	0.3	1.2	-0.6	-9.1	498.0	363.4	Caa2
Egypt	19.6	1.6	17.5	2.8	17.9	1.0	-0.3	-11.7	-12.3	350.4	255.9	B3
m.i.A.E.	*-0.3*	*0.0*	*0.3*	*-0.2*	*1.16*	*-6.0*	*0.5*	*0.7*	*-1.1*	*6.4*	*5.2*	

Source: Datastream, Reuters;[1] The data for Albania refers to January, for Egypt refers to June, for Czech Republic refers to June; [2]For Ukraine, the long-term rate refers to a government issue in dollars; [3] The (-) sign indicates appreciation.

Aggregates and bank rates for the private sector

	Loans Chg yoy %			NPL/Loans %			Foreign Liab. Chg yoy %			Deposits Chg yoy %			Loans rate[1]-NewB*. %				DepositsRate[1]-NewB*. %				Loans/Dep %		
	Last	Mth	2017	Last	mth	2017	Last	mth	2017	Last	Mth	2017	Last	mth	2017	S[4]	Last	mth	2017	S[4]	Last	mth	2017
CEE																							
Czech Rep.	5.1	May	6.5	3.5	May	4.0	6.9	Apr	70.2	5.4	May	7.6	2.47	May	2.33	C	0.81	May	0.66	H	75.4	May	75.8
Hungary	7.0	May	6.0	4.6	Mar	5.3	8.9	May	12.2	14.7	May	10.8	2.28	May	2.5	C	0.24	May	0.24	H	79.3	May	80.1
Poland	5.8	May	3.2	3.9	Dec	3.9	-11.3	Apr	-13.0	5.5	May	3.7	3.51	May	3.66	C	1.73	May	1.65	H	101.8	May	98.3
Slovakia	8.9	May	9.6	3.9	May	4.0	-13.9	May	-6.0	6.4	May	5.2	2.01	May	1.97	C[2]	0.07	May	0.07	H[2]	99.6	May	98.8
Slovenia	2.7	May	3.2	5.2	May	6.0	-14.7	May	-13.4	7.7	May	7.0	2.3	May	2.41	C[2]	0.16	May	0.14	H[2]	77.6	May	78.3
SEE																							
Albania	-0.9	May	0.5	13.3	May	13.2	-1.6	Apr	0.0	-2.7	May	-1.3	6.58	May	8.12	PS	0.75	May	0.8	PS	54.0	May	53.3
Bosnia H.	6.7	May	7.3	9.7	Mar	10.0	19.3	May	4.6	9.0	May	9.0	3.32	May	3.51	C	0.33	May	0.23	H	108.2	May	108.4
Croatia	1.9	May	-0.1	11.4	Mar	11.4	-9.4	May	-17.8	5.2	May	2.4	6.4	May	6.41	PS	0.56	May	0.68	PS	80.3	May	78.6
Romania	6.4	May	5.6	6.2	Mar	6.4	-9.7	May	-9.1	10.4	May	10.4	7.08	May	5.88	PS	1.64	May	1.08	PS	77.5	May	76.7
Serbia	3.9	May	2.1	8.6	May	9.8	32.7	May	14.4	5.9	May	3.1	8.7	May	8.2	PS	2.7	May	2.85	PS	101.0	May	101.3
CIS MENA																							
Russia	10.5	Apr	5.2	10.6	Apr	10.0	-16.4	Jan	-17.5	9.9	Apr	8.1	8.66	Apr	9.43	C	5.29	Apr	5.27	H	106.0	Apr	104.8
Ukraine	7.6	Apr	0.9	56.4	Mar	54.5	-6.3	Apr	-23.5	11.3	Apr	12.1	18.08	Apr	17.51	PS	11.29	Apr	9.56	PS	128.8	Apr	123.0
Egypt	7.6	Mar	7.1	4.5	Mar	4.9	0.4	Mar	1.1	24.4	Mar	23.8	18.3	May	19.8	C	12.0	May	13.6	H	33.6	Mar	33.9
m.i. E. A.	*2.1*	*May*	*2.2*	*n.a.*	*n.a.*	*n.a.*	*6.5*	*May*	*-2.7*	*3.0*	*May*	*1.9*	*1.1*	*May*	*1.3*	*C*	*0.4*	*May*	*0.4*	*H*	*81.4*	*May*	*81.9*

Source: Central Banks, IMF, Moody's ;[1]monthly average; [2]lending rate on current account overdraft; deposit rate on deposits up to 1 year
[4]Sector C=Corporates, H=Household, PS=Private Sector.

Intesa Sanpaolo Research Department – Head of Research Gregorio De Felice	
International Research Network Coordination	e-mail address
Gianluca Salsecci (Head)	gianluca.salsecci@intesasanpaolo.com
ISP - Research Department (Milan)	
Giancarlo Frigoli (CIS, MENA and Lat. Am. Countries)	giancarlo.frigoli@intesasanpaolo.com
Silvia Guizzo (Emerging Asia)	silvia.guizzo@intesasanpaolo.com
Antonio Pesce (CEE and SEE Countries)	antonio.pesce@intesasanpaolo.com
Wilma Vergi (Trade and Industry)	wilma.vergi@intesasanpaolo.com
Davidia Zucchelli (Banks and Financial Markets)	davidia.zucchelli@intesasanpaolo.com
International Subsidiaries' Research Departments:	
VUB (Slovakia and Czech Republic)	
Zdenko Štefanides (Head)	zstefanides@vub.sk
Andrej Arady	aarady@vub.sk
PBZ (Croatia, Bosnia I Hercegovina and Slovenia)	
Ivana Jovič (Head)	ivana.jovic@pbz.hr
Ana Lokin	Ana.lokin@pbz.hr
Ivan Odr□i□	ivan.odrcic@pbz.hr
CIB (Hungary and Poland)	
Mariann Trippon (Head)	trippon.mariann@cib.hu
Sandor Jobbagy	jobbagy.sandor@cib.hu
Banca Intesa (Serbia)	
Marija Savic (Head)	marija.v.savic@bancaintesa.rs
Branka Babic	branka.babic@bancaintesa.rs
Tijana Matijasevic	tijana.matijasevic@bancaintesa.rs
Alexbank (Egypt)	
Samer Halim (Head)	samer.halim@alexbank.com
Sahar EzzElarab	sahar.ezzelarab@alexbank.com
Hemat El Masry	hemat.elmasry@alexbank.com
Mirna Mhosen	mirna.mohsen@alexbank.com
Mariam Massoud	mariam.massoud@alexbank.com
Nahla Abdel Azim	nahla.azim@alexbank.com
International Subsidiaries' Research Contacts:	
Banca Intesa (Russia)	
Irina Lekareva	Irina.lekareva@bancaintesa.ru
Intesa Sanpaolo Bank (Romania)	
Sebastian Maneran	sebastian.maneran@intesasanpaolo.ro
Intesa Sanpaolo Bank (Albania)	
Kledi Gjordeni	kledi.gjordeni@intesasanpaolobank.al

Analyst Certification and Other Important Information

The financial analysts drafting this report state that the opinions, forecasts, and estimates contained herein are the result of independent and subjective evaluation of the data and information obtained and no part of their compensation has been, is, or will be directly or indirectly linked to the investment strategy recommended or proposed in this report.

This report has been produced by Intesa Sanpaolo S.p.A. The information contained herein has been obtained from sources that Intesa Sanpaolo S.p.A. believes to be reliable, but it is not necessarily complete and its accuracy can in no way be guaranteed. This report has been prepared solely for information and illustrative purposes and is not intended in any way as an offer to enter into a contract or solicit the purchase or sale of any financial product. This report may only be reproduced in whole or in part citing the name Intesa Sanpaolo S.p.A.

This report is not meant as a substitute for the personal judgment of the parties to whom it is addressed. Intesa Sanpaolo S.p.A., its subsidiaries, and/or any other party affiliated with it may act upon or make use of any of the foregoing material and/or any of the information upon which it is based prior to its publication and release to its customers. Intesa Sanpaolo S.p.A., its subsidiaries and/or any party affiliated with it, may from time to time have a long or short position in the aforementioned financial products.